FAIR AND EQUITABLE TREATMENT IN INTERNATIONAL LAW

The panel was convened at 9:00 a.m., Thursday, March 30, by its chair, Stephen M. Schwebel, former judge and president of the International Court of Justice, who introduced the panelists: Rudolf Dolzer of the University of Bonn; Florentino Feliciano, former justice of the Supreme Court of the Philippines and former president of the Appellate Body of the World Trade Organization; Vaughan Lowe of Oxford University; Howard Mann of the International Institute for Sustainable Development; and Andrea Menaker, Chief, NAFTA Arbitration Division, U.S. Department of State.*

REMARKS BY RUDOLF DOLZER†

The central assumption underlying the debate within the North American Free Trade Agreement (NAFTA) is that a difference exists between a freestanding version of fair and equitable and a version which ties "fair and equitable" to the rules of international law. While the existence and the nature of the difference has never been articulated on a conceptual level in detail, it is true in any event that in contemporary bilateral investment treaty (BIT) practice the two different versions do exist. In particular, German, Dutch, Swedish, and Swiss BITs have relied on the freestanding version. Earlier BITs concluded by the United States also did not refer to international law and thus continue to raise the question of the difference between the two types.

The following remarks address some aspects of the manner and ways in which international tribunals have ruled in past years on the freestanding version. Remarkably, rulings such as *OEPC v. Ecuador*[1] and *CMS v. Argentina*[2] have had to elaborate on freestanding clauses, but the tribunals have also felt it was required, in view of the arguments of defendant governments, to explain their views on the type of standard tied to general international law. Against the background of current debates within NAFTA and of academic contributions, both tribunals concluded that, at least for purposes of the facts before them, no distinction between the two types was necessary or appropriate. While the comments on these two rulings so far have not focused on this aspect, it would not be surprising if they gave rise to a debate on the assumption regarding the difference between the two versions.

* Mr. Feliciano and Ms. Menaker did not contribute written remarks.

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[1] Occidental Exploration and Prod. Co. v. Ecuador (UNCITRAL July 1, 2004). The tribunal stated:

> The Tribunal is of the opinion that in the instant case the Treaty standard is not different from that required under international law concerning both the stability and predictability of the legal and business framework of the investment. To this extent, the Treaty standard can be equated with that under international law as evidenced by the opinions of the various tribunals cited above.

Id., para. 190.

[2] CMS Gas Transmission Co. v. Argentina, ICSID No. ARB/01/8, 44 ILM 1205 (2005) (May 12, 2005). The tribunal observed:

> While the choice between requiring a higher treaty standard and that of equating it with the international minimum standard might have relevance in the context of some disputes, the Tribunal is not persuaded that it is relevant in this case. In fact, the Treaty standard of fair and equitable treatment and its connection with the required stability and predictability of the business environment, founded on solemn legal and contractual commitments, is not different from the international law minimum standard and its evolution under customary law.

Id., para. 284.

Of course, the proponents for a convergence of the two positions would face the task to identify the content of the standard as they understand it. Essentially, they could either point to the jurisprudence of NAFTA, elaborating on customary law, or to the rulings of tribunals which had to clarify the freestanding versions. A third viewpoint might attempt to find a common basis of these two lines of jurisprudence and to deduce an understanding common to both of them.

Such an evolution, rearranging the jurisprudence of the past years, would presuppose that the roots of the two versions are sufficiently close and that, on both the conceptual and practical levels, the commonalities and divergences of the two lines will allow a merger which captures the essence of both of them. For the time being, the dominant view remains that it is useful and appropriate to distinguish between the two lines.

My short remarks on the past jurisprudence on the freestanding versions concern the methodology, the vision of a functioning government underlying the jurisprudence, the relationship of the standard to the notion of good governance as it is used by governments and international financial institutions in the formulation of development policies, and on the impact on the sovereignty of the host state. As will be seen, all of these issues are interlinked. Indeed, one of the basic contemporary challenges facing international investment law is to ensure that the content of its rules is consistent with accepted notions of development policy and reinforces its objectives and conditions.

What seems to be common to all decisions on the freestanding version is the emphasis on the facts; all decisions underline that the standard is fact-driven. As to the broader methodology, however, there is no consensus. In fact, the decisions seem to go in different directions in their approach, and the different approaches may lead to different results. In a simplified perspective, three lines of reasoning may be diagnosed, which overlap in part, however.

One approach has been to resist a broad general definition or elaboration on the meaning of a standard, but instead to point to the general requirement of the need for stability, predictability, and respect for guarantees and specific commitments. An illustration may be seen in the *CMS* ruling which cites *Metalclad* and *Tecmed* on this point and states:

> 274. The Treaty Preamble makes it clear, however, that one principal protection envisaged is that fair and equitable treatment is desirable "to maintain a stable framework for investments and maximum effective use of economic resources." There can be no doubt, therefore, that a stable legal and business environment is an essential element of fair and equitable treatment.
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> 276. In addition to the specific terms of the Treaty, the significant number of treaties, both bilateral and multilateral, that have dealt with this standard also unequivocally shows that fair and equitable treatment is inseparable from stability and predictability. Many arbitral decisions and scholarly writings point in the same direction (footnote omitted).
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> 277. It is not a question of whether the legal framework might need to be frozen as it can always evolve and be adapted to changing circumstances, but neither is it a question of whether the framework can be dispensed with altogether when specific commitments to the contrary have been made. The law of foreign investment and its protection has been developed with the specific objective of avoiding such adverse legal effects."[3]

[3] *Id.*, paras. 274, 276, 277.

We can also observe an attempt on the part of tribunals in a potentially different methodological direction. This second line of decisions attempts to set forth a broader abstract definition of fair and equitable treatment, covering a wide range of circumstances and types of actions which may serve as guideposts for individual decisions. As the tribunal in *Tecmed v. Mexico* stated:

> The Arbitral Tribunal considers that this provision of the Agreement, in light of the good faith principle established by international law, requires the Contracting Parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment. The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations. Any and all State actions conforming to such criteria should relate not only to the guidelines, directives or requirements issued, or the resolutions approved there under, but also to the goals underlying such regulations. The foreign investor also expects the host State to act consistently, i.e. without arbitrarily revoking any pre-existing decisions or permits issued by the State that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities.[4]

A third line which can be found in the jurisprudence is the one preferred by the *Mondev* tribunal. This decision starts from the premise that tribunals must not construe their own idiosyncratic notions of the standard and must instead discipline their reasoning by way of reference to state practice, judicial or arbitral case law, or other sources of customary or general international law:

> At the same time, Article 1105(1) did not give a NAFTA tribunal an unfettered discretion to decide for itself, on a subjective basis, what was 'fair' or 'equitable' in the circumstances of each particular case. While possessing a power of appreciation, the United States stressed, the Tribunal is bound by the minimum standard as established in State practice and in the jurisprudence of arbitral tribunals. It may not simply adopt its own idiosyncratic standard of what is 'fair' or 'equitable' without reference to established sources of law.[5]

At the moment, these three lines of reasoning stand side by side partially overlapping one another, and it remains open which version will be accepted by the tribunals and states in the future. One may assume that a certain divergence is normal when a broad clause is applied by different tribunals addressing different factual scenarios in the absence of an institutional mechanism to provide for a more coherent approach. The current caselaw allows and leaves room for a version which consolidates the various approaches.

In assessing the current body of jurisprudence, it is interesting to note that some of the decisions have attempted to formulate a notion of a government and its qualities which is required by the contemporary standards of a BIT and which would satisfy its standards. In this context, reference was made to orderly process and timely disposition in relation to an investor, consistency, stability, predictability, and the need of the host government to act in a proactive manner protecting interests of the foreign investor. Other tribunals have pointed to the need to allow for deference to the host state and to the process of personal change

[4] Tecnicas Medioambientales Tecmed, S.A. v. Mexico, ICSID No. ARB (AF)/00/2, 43 ILM 133 (2004), para. 154 (May 29, 2003).

[5] Mondev Int'l v. United States, ICSID No. ARB(AF)/99/2, 42 ILM 85 (2003), para. 119 (Oct. 11, 2002).

and policy change. The differences in approach may be explained chiefly in light of the circumstances of the case and the specific arguments presented by the parties to the tribunals. However, it is also possible to view the decisions as potentially going in different directions, with a different emphasis in their vision of a concept of a government which is responsive for the standards laid down in an investment treaty.

In broader terms of policies of the international community, a fundamental issue concerns the cohesion between these notions of a functioning government, as set forth in a BIT and explained by tribunals, and the emerging standard of good governance which continues to move into the conceptual center of bilateral and multilateral development strategies. It is not difficult to recognize a substantial degree of commonalities between the requirements of BITs and of the notion of good governance as employed by governments in developmental practice, and it would be fascinating to compare the evolution of international investment law and of development policies in more detail. Obviously, an identity of at least the core principles in both areas will be deemed desirable. Conversely, to the extent that the call for more policy space for developing states militates against investment treaties and is inconsistent with principles of good governance, the latter ones should be properly recognized as externally anchored investments for economic, fiscal, and governmental discipline beneficial for the host state.

My final remark on fair and equitable treatment concerns the relationship to the sovereignty of the host state. The widely held and repeated assumption that the standard operates in an absolute manner is only partially correct. In principle, the standard respects the laws of the host state inasmuch as it has been generally recognized by arbitral tribunals that the domestic laws as they stand at the time of the investment must be accepted by the foreign investor and cannot form the basis of a subsequent claim. Exceptions to this principle will exist only to the extent that these laws in themselves may be seen to violate fundamental tenets embodied in the customary rules protecting aliens. Thus, in principle the standard operates not to protect the foreign investor against the laws of the host state generally, but against subsequent changes of these laws inasmuch as the investor has relied on the laws at the time of the investment and under the circumstances was entitled to do so.

The usefulness of the standard of fair and equitable treatment as such has also been questioned. I find it difficult to agree with a fundamental attack against the standard. The standard fulfills the same function as the rules of good faith or other broad clauses of a comparable nature in domestic laws, which fill gaps and inform the interpretation of other standards not covered by specific provisions. The difficulties lie, as in domestic law, in the application. In my view, the role of the judge on the international level is not fundamentally different from the role of the judge on the national level. I am aware that others disagree in view of the different legal setting and the issue of legitimacy of arbitral tribunals. However, international arbitral institutions have in principle served the international community now for over two hundred years with respectable success, and the tribunals have also been able to interpret and apply general principles and broad clauses. Today the main purpose of investment treaties is to create an investment-friendly climate that gives expression to the respect for the rule of law, and past experience gives reason to believe that arbitral tribunals are in principle well-suited to interpret and apply the terms of such treaties.

REMARKS BY VAUGHAN LOWE*

I have four broad points to make. The first is that the standard of fair and equitable treatment is plainly context-specific and best left to develop through the case-by-case process that typifies doctrinal development in common law systems. While lawyers tend to have an approach to notions of fairness and equity that philosophers would find appallingly unsophisticated, there is little merit in trying to fabricate a comprehensive doctrine of fair and equitable treatment *in abstracto*. In that sense, the doctrine or regime should operate through general principles and not through detailed rules. Tribunals should decide concrete cases, and commentators should analyze them and seek to identify and articulate more specific principles, such as transparency and legitimate expectations, implicit within them. As the caselaw builds, it may be necessary to redefine and reclassify the principles; but tribunals should remain focused on the central notion of fair and equitable treatment, and not on the more specific principles distilled from jurisprudence.

Tribunals are charged, by agreement of the parties, with application of the fair and equitable standard in circumstances where the parties cannot themselves agree upon what is fair and equitable. That is not to say that tribunals have a totally unfettered discretion. The right and duty to apply the fair and equitable standard is not at all the same thing as the right to decide a case *ex aequo et bono*; and one would expect a considerable measure of consistency between awards so as to engender a proper degree of predictability in the law, which is essential as a matter of fairness to investor and host state alike.

One area where one might expect a consistent approach to emerge is that of the definition of the factors that are relevant to the application of the fair and equitable standard. In much the same way that tribunals in the law of the sea have identified the factors that are and are not relevant in effecting an ''equitable'' delimitation of maritime zones between neighboring states, investment tribunals could usefully articulate the kinds of factors and arguments that are relevant in the context of fair and equitable treatment. For example, in the wake of *Maffezini*, *Metalclad,* and the Schwarz opinion in *Myers*, it would probably be generally accepted that, whatever weight it might be given in a specific case, the question of the transparency of governmental regulation is at least appropriate to questions of fairness and equity, in a way that arguments in favor of using BIT claims to redistribute global wealth would not be appropriate. Notions of legitimate expectations and of the good faith and intentions, of both the government and the investor, are among the other matters that might appear on the list of relevant factors that a tribunal could reasonably, and perhaps should, take into account in determining whether there has been ''fair and equitable'' treatment.

Fair and equitable treatment is a matter distinct from protection against expropriation and discrimination, and must not become subsumed within them. That is one reason why tribunals should go back to the core questions of fairness and equity in each case. But not all BITs are precisely the same, and while MFN clauses may tend to homogenize the standard of treatment, tribunals must be sensitive to the differences in the legal and factual contexts in which they are called upon to apply the fair and equitable standard in each specific case.

My second point is a response to the criticism that BITs are unbalanced, pro-investor instruments that are inherently biased against governments. That is true, but misleading. BITs are only half of the picture. Beyond the BIT, the host state government has an inherent power to legislate so as to alter not only its own general laws but also the specific bargains that it has struck with particular investors. And the government usually has a very considerable

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degree of control over the economy and the army. Rich and powerful as multinational corporations may be, in the game of creating and maintaining legal rights and duties around a foreign investment the government holds most of the high cards. BITs, plainly favoring the investors' interests, do something to redress the balance. One may question whether the balance has been struck at the right point; but it is not, I think, sensible to criticize BITs for their one-sidedness, which is apparent if the BITs are considered in isolation.

As things stand, the balance between states' and investors' interests can be adjusted relatively easily, by a combination of legislation and actions under BITs. Negotiation and renegotiation of comprehensive BITs that set out the rights and duties of investor and flag state alike is an unrealistic aim.

My third point concerns the temporal duration of fair and equitable treatment. It is sometimes assumed that the standard applies only to conduct before the arbitral proceedings begin. I raise the question whether that is correct. Professional ethics, and tribunal control, generally ensure that parties in litigation treat each other fairly and equitably during the proceedings. But there is also a question of post-hearing fairness and equity.

If, for example, all of the amounts claimed from Argentina in BIT arbitrations were awarded in full, Argentina could not immediately satisfy all of the awards. How should it act? Is payment on a first-come, first-served basis, which leaves recovery to a lottery driven by the accidents of tribunal timetables, satisfactory? Or could an investor claim that a state in this position must also treat investors fairly and equitably when it comes to paying out on arbitral awards? In other words, may the obligation of fair and equitable treatment positively oblige states to organize some kind of phased partial payment of awards, of the kind for which national bankruptcy and insolvency laws commonly provide? The recent IMF attempts to find a satisfactory mechanism for sovereign debt rescheduling appear to have run into the ground, but BITs might provide a useful framework within which states could create such a mechanism unilaterally.

My fourth point, which completes my response to the questions which Carolyn Lamm asked her panelists to address, concerns the idea of a standing appellate or adjudicatory body, intended to improve uniformity and predictability within the investment regime. I think that this is a bad idea. At the end of an arbitration, the legal teams and the documents are all in place, so that the marginal cost of an appeal would be relatively low. The scale of claims in investment arbitrations is such that on any rational analysis even a one or two percent chance of success would justify making the marginal expenditure on an appeal. There is clearly a risk that a standing appellate mechanism would simply prolong proceedings, and perhaps generate a case-load so large that no single group of people could handle it. There is, in my view, great merit in limiting recourse against awards to reviews based, as in the ICSID system, on fundamental procedural defects. Litigants, and even lawyers, have lives to get on with.

Is *Fair and Equitable* Fair, Equitable, Just, or Under Law?

By Howard Mann[*]

The overall theme of this 100th anniversary meeting of the ASIL, "A Just World Under Law," provides an excellent test by which to evaluate the evolution of the fair and equitable treatment standard found in almost all international investment agreements (IIAs). Indeed,

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